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Message Text

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ACTION SS-14

INFO OCT-01 ISO-00 EUR-08 EB-03 SP-02 TRSE-00 NSC-05

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O 301311Z NOV 76
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 8256

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 19262

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E.O. 11652: GDS
TAGS: EFIN, UK
SUBJECT: SITUATION REPORT, NOVEMBER 30

REF: (A) STATE 267168; (B) LONDON 19170

1. EMERGING CABINET VIEW ON ECONOMIC MEASURES. THE PRESS HAS CONTINUED TO SPECULATE--OFTEN DRAWING ON WHAT APPEAR TO BE AUTHORITATIVE SOURCES -- ON THE CABINET'S POSITION REGARDING THE MEASURES TO BE TAKEN AS CONDITIONS FOR THE 3.9 BILLION IMF LOAN. ALTHOUGH DETAILS VARY, THE CENTRAL THRUST OF ALL THE STORIES IS THAT A SUBSTANTIAL MAJORITY OF THE CABINET OPPOSES ANY ACTIONS WHICH WOULD HAVE A SIGNIFICANTLY DEFLATIONARY EFFECT ON THE ECONOMY. VIRTUALLY ALL PRESS ACCOUNTS REPORT THAT CHANCELLOR HEALEY, SUPPORTED BY TRADE SECRETARY DELL AND ODM MINISTER PRENTICE, HAS BEEN ATTEMPTING TO PREPARE THE GROUND FOR A PACKAGE WHICH WOULD ACHIEVE A MAJOR REDUCTION IN THE PUBLIC SECTOR BORROWING REQUIREMENT, THROUGH SOME COMBINATION OF FURTHER CUTS IN PUBLIC SPENDING AND INCREASED INDIRECT TAXATION. CABINET OPPOSITION TO THIS APPROACH IS REPORTEDLY LED BY FOREIGN SECRETARY CROSLAND, ENVIRONMENT SECRETARY SHORE AND CHANCELLOR OF THE DUCHY OF LANCASTER LEVER, WHO ARGUE THAT SUCH ACTION WOULD PUSH THE ECONOMY INTO RECESSION,
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INCREASE UNEMPLOYMENT AND DELAY RECOVERY. MOST OF THE

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CABINET REPORTEDLY FIND THIS ARGUMENT PERSUASIVE --
WHILE THE PRESS ACCOUNTS OF THE LINE-UP VARY, LEVER TOLD
AN EMBOFF THAT TWO-THIRDS OF THE CABINET NOW OPPOSE THE
TREASURY RECOMMENDATION. PRIME MINISTER CALLAGHAN HAS
APPARENTLY NOT YET TIPPED HIS HAND. WE WOULD NOT
VENTURE TO PREDICT THE ULTIMATE DECISITN. HOWEVER, THE
EMERGING CABINET CONSENSUS. AND THE VIEWS OF THE TUC AND
LABOR BACKBENCHERS, ARE BOUND TO WEIGH HEAVILY WITH
CALLAGHAN, WHO IS A HIGHLY POLITICAL ANIMAL.

2. LE HURRAY, TUC GENERAL SECRETARY HAS THROWN HIS
FULL WEIGHT INTO THE ARGUMENT OVER THE SIZE OF THE
AUSTERITY PACKAGE NECESSARY TO MEET IMF DEMANDS.
MURRAY, ACCORDING TO THE "TIMES" NOVEMBER 30, HAS WARNED
THAT ANY CONDITIONS TO THE PROPOSED IMF LOAN WHICH WOULD
INVOLVE DEFLATION AND STRINGENT CUTS IN PUBLIC SPENDING
WOULD THREATEN THE SOCIAL CONTRACT. THE "TIMES" INDI-
CATED THAT MURRAY HAS WARNED IMF OFFICIALS THAT IF HARD
DEFLATIONARY ACTIONS WERE TAKEN, THE TRADE UNIONS MIGHT
OPT FOR A TOUGH ECONOMIC POLICY INCLUDING WIDESPREAD
IMPORT CONTROLS. (IT ADDS, HOWEVER, THAT SOME TUC GEN-
ERAL COUNCIL MEMBERS - LORD ALLEN AND TOM JACKSON -
CHALLENGED MURRAY'S TOUGH TALK.) MURRAY'S WARNING DOES
NOT COME AS A SURPRISE, OF COURSE, SINCE THE TRADE
UNIONS HAVE CLEARLY AND CONSISTENTLY OPPOSED A TOUGH
AUSTERITY PACKAGE. IT IS ALSO CLEAR THAT MURRAY IS
USING THE WEIGHT OF THE TUC - WHICH IS CRITICAL - IN
FAVOR OF THE SOFT-LINERS IN THE CABINET WHO ARE TAKING
A SIMILAR POSITION - THAT TOUGH DEFLATIONARY ACTIONS
WOULD BE POLITICALLY DANGEROUS. MURRAY'S VOICE IS THUS
ADDED TO THOSE OF INDIVIDUAL UNION LEADERS, THE CON-
FEDERATION OF BRITISH INDUSTRY. AND THE NEO-KEYNESIANS.
THIS RATHER DISPARATE GROUP IS OPPOSED TO INCREASING
UNEMPLOYMENT SHARPLY IN THE SHORT RUN AS SPENDING CUTS
AND CREDIT RESTRAINT BEGIN TO BITE. AS A CONSTELLATION
OF POLITICAL FORCES, THEIR WEIGHT IS FAR FROM NEGLIGIBLE.
WHILE NOT FULLY AGREED ON WHAT IS TOLERABLE, THEY HAVE
BEEN SKETCHING THE BOUNDARIES WITHIN WHICH AN HMG-IMF
ACCORD SHOULD FALL.

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3. CONGRESSMAN REUSS ADDRESSED A LONDON INVESTORS CON-
FERENCE YESTERDAY; HE WARNED AGAINST SHARP SPENDING
CUTS WHICH HE DESCRIBED AS A MISTAKEN CONDITION FOR THE
IMF DRAWING. CALLING BRITAIN'S BASIC PROBLEMS STRUCT-
URAL, HE SAID THEY COULD ONLY BE SOLVED WHEN BOTH UN-
EMPLOYMENT LEVELS AND BUSINESS CONFIDENCE WERE AT
REASONABLE LEVELS. HE ADDED THAT "IT WAS NOT FOR THE
US TO IMPOSE THE WRONG REMEDIES ON THE UK IN HER FINAN-

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CIAL AGONY". REUSS RULED OUT ANY USG ACTION TO FUND

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STERLING BALANCES. RATHER. HE SUGGESTED IN A BBC RADIO INTERVIEW THAT HOLDERS OF STERLING BALANCES SHOULD BE OFFERED THE OPPORTUNITY TO CONVERT THESE INTO 10-20 YEARS OBLIGATIONS DENOMINATED PERHAPS IN SDRS OR IN HARD CURRENCIES TO BE REPAID BY BRITAIN OUT OF NORTH SEA OIL REVENUES.

4. THE CALL BY THE NATIONAL UNION OF MINERS EXECUTIVE FOR INDUSTRIAL ACTION WHICH COULD INCLUDE A NATIONAL STRIKE WAS BOLSTERED BY REACTION FROM A NUMBER OF KEY REGIONAL GROUPS IN YORKSHIRE, SCOTLAND AND SOUTH WALES, THE THREE MOST MILITARNT AREAS IN THE NUM, WHERE LEADERSHIP MEETINGS URGED MINERS TO VOTE IN FAVOR OF THE NUM EXECUTIVE'S CALL UNLESS THE NATIONAL COAL BOARD MEETS DEMANDS ON EARLY RETIREMENT. THERE IS LIKELY TO BE SUBSTANTIAL SUPPORT FROM ALL AREAS FOR THE EXECUTIVE'S CALL FOR AUTHORIZATION OF SOME FORM OF INDUSTRIAL ACTION WHEN THE VOTE IS ANNOUNCED ON DECEMBER 14, AND THE NATIONAL COAL BOARD WILL BE ATTEMPTING TO COMPROMISE THE DISPUTE.

A LEADING NCB OFFICIAL HAS ACKNOWLEDGED TO US THAT BRITAIN IS AT THE "BOTTOM OF THE EUROPEAN PILE" BY

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HAVING THE POOREST RETIREMENT BENEFITS. PAUL ROUTLEDGE, WHO TALKED TO YORKSHIRE MINERS ON THE ISSUE, SAYS (TIMES, NOV 30) THERE IS "A SENSE OF ANGER AND FRUSTRA-
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TION EVIDENT" AMONG THE MINERS IN THAT AREA AND "BITTER-NESS" FROM MEN SUFFERING FROM COAL DISEASES "WHO FEAR THEY WILL NOT LIVE LONG ENOUGH TO ENJOY THE FRUITS OF THE DISPUTE...".

THERE IS A DANGER THAT THE MILITANTS FROM THESE AREAS MAY TRY TO GET THE NUM TO "GO FOR BROKE BY IN-SISTING ON THE FULL DEMAND FOR EARLY RETIREMENT BE MET (BY AGE 60 IN JANUARY 1977 AND 55 STARTING IN 1980). THE NATIONAL COAL BOARD WILL NOT BE ABLE TO ACCEPT THIS EXTREMELY COSTLY PROPOSAL. HOWEVER, A COMPROMISE SOLUTION STILL SEEMS LIKELY.

5. SPENDING CUTS - HOUSING. H.M. TREASURY IS REPORTED BY THE TIMES TO BE PROPOSING LARGE CUTS IN GOVERNMENT HOUSING SUBSIDIES. CURRENTLY. TENANTS IN PUBLIC HOUSING PAY ONLY 43 PERCENT OF THE RENT CHARGE WITH THE GOVERN-MENT SUBSIDIZING THE REMAINING 57 PERCENT. IT HAD BEEN PLANNED TO REDUCE THIS SUBSIDY TO 50 PERCENT OVER A PERIOD OF 5 YEARS. H.M. TREASURY IS PUSHING FOR AN EARLIER REDUCTION OF MORE SUBSTANTIAL PROPORTIONS. SUB-SIZIDED RENTS ARE A KEY ELEMENT IN THE SOCIAL CONTRACT BETWEEN UNIONS AND GOVERNMENT. HIGHER RENTS RESULTING FROM THE TREASURY PROPOSAL WOULD PLACE FURTHER STRAIN ON THAT AGREEMENT.

6. EC SUMMIT. AT THE EUROPEAN COUNCIL MEETING IN THE HAGUE, THE PRIME MINISTER IS REPORTED TO HAVE ARGUED STRONGLY AGAINST ANY DEVALUATION OF THE GREEN POUND. HE CITED THE FRAGILITY OF THE SOCIAL CONTRACT WITH ORGAN-IZED LABOR, WHICH WOULD BE STRAINED BY RESULTING HIGHER FOOD PRICES. CALLAGHAN'S DEFENSE CAME IN THE WAKE OF GISCARD D'ESTAING'S CRITICISM OF THE INCREASING DRAIN OF GREEN CURRENCY SUBSIDIES ON THE COMMUNITY BUDGET. THE FT REPORTS THAT CALLAGHAN IS TO HAVE BREAKFAST WITH SCHMIDT TODAY TO DISCUSS THE POSSIBILITY OF ADDITIONAL

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SUPPORT MEASURES FOR STERLING BEYOND THE $3.9 BILLION
IMF LOAN.

7. IMF MONITORING OF UK. A FINANCIAL TIMES ARTICLE SPECULATES THAT THE IMF LOAN WILL BE MADE IN INSTALMENTS AS IT MONITORS THE UK'S ECONOMIC PERFORMANCE. THE IMF IS SAID TO BE INTERESTED PRIMARILY IN THE SIZE OF DOMESTIC CREDIT EXPANSION ALTHOUGH IT HAS NOT INDICATED SPECIFIC TARGET FIGURES. WORK IN H.M. TREASURY IS SAID TO BE FOCUSING ON CUTS IN "SPENDING"--NOTABLY TRANSFER PAYMENTS--WHICH EXCEED 1 BILLION POUNDS.

8. MILTON FRIEDMAN'S "60 MINUTES" INTERVIEW GOT HEAVY PRESS PLAY BUT HIS VIEWS WERE CRITICIZED FOR THEIR NAIVETE.

9. FOREIGN EXCHANGE AND FINANCE. ALL MARKETS MOVED QUIETLY ON MONDAY, AS BUYERS AND SELLERS OF ALL ASSETS WERE SAID TO BE SHOWING CAUTION WHILE THE IMF CONCLUDES ITS DELIBERATIONS ON THE $3.9 BILLION CREDIT. STERLING CLOSED MONDAY AT $1.6485 UNCHANGED FROM FRIDAY'S CLOSE. EQUITY PRICES WERE ON THE AVERAGE VIRTUALLY UNCHANGED AS THE FINANCIAL TIMES INDEX OF 30 INDUSTRIALS CLOSED MONDAY AT 302.5 COMPARED WITH FRIDAY'S 302.4 CLOSING. GILT PRICES EASED SLIGHTLY, ON THE ORDER OF 1/16.

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EARLY TUESDAY TRADING SAW CONTINUED QUIET IN

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MARKETS. STERLING TRADED IN THE NEIGHBORHOOD OF MONDAY'S CLOSE. THE FINANCIAL TIMES INDEX EASED TO 300.3 AT 10:00. GILT PRICES, HOWEVER, CONTINUED TO FALL, THE DECLINES IN THE SHORTS BEING ON THE ORDER OF 1/16 AND ON LONGS 1/4.

THE HIGH INTEREST RATES THAT HAVE PREVAILED IN THE MONEY MARKET DURING THE LAST FEW WEEKS HAVE LED FINANCE HOUSES TO INCREASE THEIR BASE RATE FROM 14 TO 15 PERCENT.

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